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SUBJECT:US/SOVIET OIL NEGOTIATIONS - SECOND WEEK

REF: STATE 24641

1. SUMMARY. AFTER THE TWO SIDES REACHED STALEMATE ON A SPECIFIC PRICE FORMULA, THE US SIDE DECIDED TO SEEK PROMPT CONCLUSION OF AN OIL AGREEMENT WITHOUT SUCH A FORMULA. THERE IS STILL DISAGREEMENT OVER CERTAIN POINTS IN THE TEXT. THE MAIN QUESTION STILL TO BE SETTLED IS SHIPPING RATES. END SUMMARY

2. THE OIL NEGOTIATIONS CONTINUED THROUGHOUT THE WEEK OF FEBRUARY 2-6. BOTH SIDES AGREED ON THE FOLLOWING BASIC PRINCIPLES: (A) PRICES FOR THE OIL AND PRODUCTS TO BE SHIPPED UNDER THE AGREEMENT SHOULD BE SUFFICIENTLY
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ATTRACTIVE TO ENCOURAGE US BUYERS TO SWITCH TO THE NEW

SOVIET SOURCE OF SUPPLY; (B) US AND SOVIET-FLAG VESSELS SHOULD HAVE AN OPPORTUNITY TO CARRY THE OIL AND PRODUCTS SHIPPED UNDER THE AGREEMENT IN ACCORDANCE WITH THE TERMS OF THE MARITIME AGREEMENT; AND (C) AN OIL AGREEMENT WOULD SERVE THE INTERESTS OF BOTH COUNTRIES BY BROADENING THEIR ECONOMIC RELATIONS, THEREBY STRENGTHENING THEIR POLITICAL

TIES. AN AGREEMENT COULD ALSO BE A FIRST STEP TOWARD A MORE SIGNIFICANT FUTURE RELATIONSHIP IN THE FIELD OF ENERGY.

3. WE REACHED A TOTAL IMPASSE, HOWEVER, OVER THE SPECIFIC PRICE FORMULA TO BE INCLUDED IN THE AGREEMENT. THEY STUCK ADAMANTLY TO THEIR POSITION THAT PRICES SHOULD BE SET AT MARKET LEVELS. THEY REFUSED TO ACCEPT IN THE GOVERNMENT-TO-GOVERNMENT AGREEMENT ANY EXPLICIT DISCOUNT, HOWEVER CAMOUFLAGED, THAT WOULD CAUSE THEM TO HAVE TO REDUCE PRICES IN OTHER MARKETS, OR THAT COULD BE VIEWED AS A BREAK IN OPEC PRICE LEVELS. WE REPLIED THAT FOR IMPORTS TO TAKE PLACE, THE SOVIET OIL WOULD HAVE TO BE PRICED AT LEAST AS LOW AS THE MOST FAVORABLY-PRICED ALTERNATIVE SUPPLIES DELIVERED IN THE US. DURING LENGTHY DISCUSSIONS BOTH AT THE HEAD OF DELEGATION LEVEL AND IN THE WORKING GROUP, IT BECAME CLEAR THAT THERE WOULD BE NO WAY TO BRIDGE THIS GAP. WE DECIDED THAT INSTEAD OF ACCEPTING A WATERED-DOWN PRICE FORMULA OR NO AGREEMENT AT ALL, IT WOULD BE PREFERABLE TO GET AN AGREEMENT THAT AT LEAST CONTAINED A FIRM SOVIET COMMITMENT TO OFFER CRUDE AND PRODUCTS FOR DELIVERY TO THE US MARKET.

4. WE THEN EXPLORED WITH THE SOVIETS THE POSSIBILITY OF AN AGREEMENT WITHOUT A SPECIFIC PRICE FORMULA. THE SOVIETS WOULD BE COMMITTED TO SUPPLY TEN MILLION TONS A YEAR. PRICES WOULD BE FIXED IN COMMERCIAL CONTRACTS AT MUTUALLY ACCEPTABLE LEVELS, WITH A VIEW TO ACHIEVING THE CONTEMPORATED VOLUME OF SALES. THE TWO SIDES WOULD REVIEW THE IMPLEMENTATION OF THE AGREEMENT THROUGH ANNUAL CONSULTATIONS.

5. THE SOVIETS ACCEPTED THIS APPROACH AS A BASIS FOR DISCUSSION, AND WE HAVE AGREED ON LANGUAGE FOR MOST OF AGREEMENT.

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MENT. THE MAIN QUESTION STILL TO BE RESOLVED IS SHIPPING RATES. BEFORE THE OIL AGREEMENT IS SIGNED, WE WANT TO AGREE ON RATES, TERMS AND CONDITIONS OF CARRIAGE THAT WILL ENSURE THE PARTICIPATION OF US AND SOVIET FLAG VESSELS. WE BELIEVE THAT THIS CAN BE DONE AT SOMETHING CLOSE TO MARKET RATES, BUT WE WANT A MINIMUM GUARANTEE SUFFICIENT TO COVER SUCH INCREMENTAL COSTS AS TANKER CLEANING AND ADDITIONAL PORT CHARGES. BLACKWELL IS INVITING AVERIN TO

WASHINGTON TO DISCUSS SHIPPING RATES WHILE AT LEAST SOME
OF THE SOVIET OIL DELEGATION ARE STILL HERE (SEE SEPARATE
TELEGRAMS). WE HOPE THESE SHIPPING RATE TALKS CAN BEGIN
EARLY NEXT WEEK. SISCO

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